BROWN - FORMAN

October 21, 2003

VIA FACSIMILE

Chief
Regulations and Procedures Division
Alcohol and Tobacco Tax and Trade Bureau
P.O. Box 50221
Washington, DC 20091-0221

Attn: TTB Notice No. 4

Dear Sir or Madam:

Brown-Forman Corporation (“Brown-Forman”) respectfully submits these comments on Notice 4, Flavored Malt Beverages and Related Proposals. Brown-Forman is a maufacturer and marketer of consumer products based in Louisville, Kentucky. Thc company has been a manufacturer of finc whiskey and other beverage alcohol since 1870. Currently, Brown-Forman produces and distributors a flavored malt beverage product known as Jack Daniel’s Country Cocktails with annual sales of approximately 2.2 million flat cases. In addition, Brown-Forman has partnered with Miller Brewing Company to produce a second flavored malt beverage: Jack Danici’s Original hard Cola. Last year, sales of Hard Cola were approximately 1.1 million cases.

Brown-Forman agrees with Notice 4 that the Alcohol & Tobacco Tax & Trade Bureau (TTB) should take the lead in developing regulatory standards for flavored malt beverages (FMBs), as they represent a significant and growing part of the beer market. However, Brown-Forman respectflully disagrees with the 0.5% alcohol by volume (ABV) standard proposcd in Notice 4 and urges TTB to adopt instead the more reasonable “majority standard” that requires more than 50% of the alcohol in an FMB to be derived from fermentation of the product’s beer/malt beverage base (“the 51% standard”), Brown-Formans reasoning is set forth below.

Further, we strongly recommcnd TTB consult with Brown-Forman and other FMB manufacturers to determine a realistic implementation timcline upon adoption of any new standard. For the reasons set out below, we believe that at least two years is appropriate.

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These comments will briefly summarize the history leading up to thc present debate over the formulation and labeling of FMBs. Our comments cover:

(1) the reasons why a final rule should adopt a 51% standard instead of the proposed 0.5% standard;

(2) our comments related to FMB refomulation and a reasonable timetable to complete; and

(3) the reasons why a final rule should not limit alcohol content labeling solely to malt beverages containing non-beverage flavors.

HISTORY OF FLAVORED MALT BEVEREAGES

As adoptcd and enforced by the Bureau or Alcohol, Tobacco & Firearms (“ATF”) for more than thirty years, federal policy has allowed brewers to add non-beverage flavors containing alcohol to crcatc products taxed as “beer” under Chapter 51 of the Internal Revenue Code IRC, 26 U.S.C. §§ 5001-5691) and classified as ‘malt beverages” under thc Foderal Alcobol Administration Act (FAA Act, 27 U.S.C. §§ 201-211). FMB's first became popular in the late 1960s with products such as Malt Duck. Notably, the 1960s versions are similar to today’s FMBs in that brewers blended substantial amounts of water and sweeteners to a relatively small malt beverage base as woll as added non-beverage flavors that contributed flavor and alcohol to the finished product.

Wine coolers also played a role in the development of FMBs. Popular in the 1980s, the wine cooler combined a fermented wine base with water, sweeteners and non-beverage flavors with taste profiles different from their grape wine base. Brown-Fornian manufactured and sold California Coolers during this time period. As early as the mid-1980s, wine cooler brands derived substantial amounts of alcohol from their non.beverage flavors. Brown-Forman is unaware of any federal regulation or policy that restricts the amount of alcohol non-beverage flavors can contribute to a wine cooler.

The FMB category expanded considerably when Stroh Brewery and Canandaigna Wine Company began to market “cooler” products made with a malt beverage base instead of wine. The development of the malt-based cooler accelerated in the late 1980s with the introduction of the "Seagram Spritzcr." By the early 1990s, Seagram cooler products and other brands such as Bacardi Breezer and Gallo’s Battles & James moved from a wine base to a malt beverage base. Like the FMBs from the 1960’s, these FMBs derived a substantial majority of their alcohol from added non-beverage flavors, not the fermented base, and did not taste or smell like a traditional malt beverage, In addition, these FMB products used the names of distilled spirits brands (e.g. Bacardi and Seagram) to help draw consumer focus.

These products were developed pursuant to a long history of approval by ATF of both formulas and labels. ATF had recognized since at least the early 1970s that brewers were adding non-bevcrage flavors to malt beverages. (See Revenue Procedure 71-26.) Similarly FMB producers complied with a 1957 ATF policy that required review and approved of the SOP for cach FMB produced in the United States. (See Industry Circular 57-17). ATF's approval of these SOPs confirmed a producer's ability to use non-beverage flavors up to the quantities indicated in the SOPs. ATF also reviewed and approved a certificate of label approval (COLA) for every FMB product.

In February 1996, ATF published Ruling 96-1 in response to reports regarding the development of a high-alcohol FMB using non-beverage flavors as its primary alcohol source. Importantly, ATF held that it would not limit thc alcohol derived from flavorings in FMBs containing not more than 6% ABV, subject to rulemaking "in the near future" ATF never conducted rulemaking after the publication of Ruling 96-1 By late 1997, ATF's Agenda in the Federal Register listed this possible rulemaking as "withdrawn" for further study, and it completely disappeared from the Agenda by the end of 1998.

Througout the late 1990s, ATF continued to review and approve SOPs and COLAs for FMB products. Brown-Forman is unaware of an attempt by ATF to "qualify" or time limit those approvals pending further rulemaking — a practice ATF has employed when pending regulations could affect the validity of such approvals. Although Ruling 96-1 held that SOPs for FMBs should include information about alcoholic ingredients and sources, ATF did not enforce this requirement until the publication of Ruling 2002-2 in April 2002.

Another period of significant expansion of the FMB category began in 1999 when "hard" lemonades and teas became popular with American consumers. Once again, like their predecessors, these FMBs derived a substantial majority of their alcohol from flavors and did not look or taste like conventional beer.

Upon the introduction of Tequiza in the late 1990's with a label referencing "the flavor of tequila," ATF for the first time expressed its interest in limiting the use of flavors in FMBs with an alcohol content below 6% ABV. Given the considerable investment in this category by producers, it was no surprise that this activity caused considerable concern among these producers. An ad hoc coalition met with TTB officials in 2000 to learn more about the Agency's concerns with, and future plans for, the category. It is Brown-Forman' s understanding that the coalition received assurances that ATF planned no change in policy toward the addition of alcohol to malt beverages containing 6% ABV or less.

The rapid growth of hard lemonades and teas helped fuel the introduction of FMBs that incorporated the names of well-known distilled spirit brands. The first, Smirnoff lee, was introduced late in 2000 and was soon followed by new FMBs from all three major domestic brewers. Some of these brewers partnered with established distilled spirit brand owners in order

to gain access to well-known distilled spirit brand names. Brown-Forman entered into such a partnership with Miller Brewing Company to jointly produce Jack Daniel's Original Hard Cola.

The 2002 introduction of FMBs declaring on their labels that they were made with "flavor containing vodka" (in the case of Smirnoff Ice) caused substantial controversy at the State level. A few State regulators raised their concerns with ATF and FMB producers. In response to these concerns, ATF published Ruling 2002-2 on April 8, 2002. The Ruling clarified federal policy by stating that malt beverages can employ the brand name of a well-known distilled spirit or thc name of a mixed-drink cocktail as their brand or fanciful names. The Ruling held, however, that the use of distilled spirit standards of identity is prohibited in a malt beverage statement of composition. In addition, such use would be presumed misleading if it appears elsewhere on the label or in the advertising of a malt beverage.

While somewhat lengthy to set out, this history establishes first and foremost that ATF has been aware of the use of non-beverage flavors in malt beverage products for more than thirty years. It is also abundantly clear that producers invested considerable time and resources in developing FMBs in reliance on the long-standing approval by ATF on the formulation of FMBs. These key considerations are the foundation for our comments.

COMMENTS

Brown-Forman agrees that the federal government should establish clear, consistent standards for the formulation of FMBs. Notice 4, however, does not adequately explain why such a standard should limit thc alcohol contribution of non-beverage flavors to just 0.5% ABV instead of the more reasonable 51% standard, a standard which TTB acknowledges is permissible under federal law!

TTB fails to produce any evidence of consumer confusion to support its rulemaking and, indeed, available evidence demonstrates that consumers do not care about the alcohol source in an FMB. Notice 4 also fails to explain why either of its stated reasons for acting – alleged consumer confusion and the non-specific concerns of state regulators – are better served by a 0.5% standard versus a 51% standard. Given the absence of a compelling reason for selecting a 0.5% standard over a less-restrictive one, the additional costs that a 0.5% standard would impose on the producer, and in turn to the consumer, strongly argue against its adoption.

Furthermore, neither the IRC nor the FAA Act give TTB the statutory authority to limit the use of non-beverage flavors in a "beer" or "malt beverage." Thc text of the definitions, including the legislative history of both statutes, are completely void of any suggestion that Congress intended to limit the use of non-beverage flavors in a bccr or malt beverage.

If the TTB adopts the 0.5% standard over the less-restrictive 51% standard, it is incumbent upon TTB to work closely with the industry to develop a reasonable timetable for the necessary refonnulation work that would need to take place. Similarly, new equipment must not

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only be designcd but built and tested, again requiring considerable time and financial commitments from each producer, Given the long history of ATF approval of FMBs as currently formulatcd, fundamental fairness requires YI7B to provide the industiy significant latitude in adopting a timetable that works for all involved.

Finally, while Brown-Forman supports alcohol content labeling to inform consumers, we see no roason why Notice 4 singles out malt beverages containing non-beverage flavors as the only malt beverages required to bear an alcohol content statement.

1. TTB SHOULD ADOPT A 51% STANDARD AND REJECT THE MORE RESTRICTIVE 0.5% STANDARD

Notice 4's proposed new formulation standards for a product to qualify as a malt beverage profoundly threatens Brown-Forman's ongoing FMB business. Although any change to established production methods will disrupt our FMB business and require costly modifications, Brown-Forman can accept a majority standard requiring that at least 50% of the alcohol in a malt beverage derived from fermentation of the product's base. The 0.5% ABV limit proposed by TTB, in contrast, presents a true threat to our existing business without a sound policy justification behind it.

Notice 4 cites the potential for consumer confusion as one of the two policy grounds for adopting the .5% ABV limit. (See 68 reg. at 14296). Notice 4 cannot rely upon consumer confusion as a justification for rulemaking when it does not cite any evidence showing that consumers are, in fact, confused. To justify the rule, TTB must consider probative evidence demonstrating that the perceived consumer confusion actually affects consumers' purchasing decisions; i.e., that the confusion is material. See, e.g. Ibanez v. Florida Dept. of Bus. & Prof Reg., 512 U.S. 136 (1994). Notice 4 contains no evidence of consumer confusion and it does not point to a single consumer complaint about the alcohol source in FMBs. This absence of evidence is glaring.

Moreover. Notice 4 arbitrarily imposes a more rigorous standard on malt beverages than on other beverage alcohol products as a way to address the potential of confusion. Accepting for the sake of argument that consumers care about the source of alcohol in the products they drink, then consumers would logically expect that the wine coolers they purchase derive a significant portion of their alcohol from the fermentation of grapes. Yet TTB has never deemed it necessary to limit the amount of alcohol that flavors can contribute to a wine cooler product.

Similarly, Notice 4's proposed 0.5% standard contrasts with TTB's regulations on the source of alcohol in certain distilled spirit products. TTB permits some distilled spirit products to derive up to half of their alcohol from added wine that was never subject to distillation. See 27 CER Sec. 5.11's definition of Distilled Spirits. This rule is completely consistent with the

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51 % standard favored by Brown-Forman for FMBs and inherenfly inconsistent with the restrictive 0.5% standard proposed by Notice 4. We are at a loss to understand how TTB can explain or justify applying different standards dependent upon whether the product is beer, wine or distilled spirits.

Notice 4 also relies on undefined State concerns as another reason for imposing limits on the use of flavors in FMBs. Admittedly, those concerns have prompted States to request that TTB define FMBs and impose limits on the addition of alcohol to malt beverages through the use of flavors. If TTB fails to take action, States could develop their own definitions for FMBs resulting in impossible confusion for producers. Brown-Forman thus agrees with the need for a national FMB formulation standard and, for that reason, urges TTB to adopt the 51% standard included in Notice 4. TTB has completely failed to identify specific State concerns that justify the proposed 0.5% standard instead of the majority standard.

Without consumer confusion or specific State concerns, TTB should justify why it has selected the most resitictive rule for its malt beverage standard. Notice 4 clearly acknowledges that the IRC and the FAA Act fail to address how much, if any, of a malt beverage’s overall alcohol content may come from the addition of flavors. Notice 4 also recognizes that TTB and its predecessor agencies have historically permitted alcohol from flavorings to contribute alcohol to products classified as either beer or malt beverages. These fundamental facts lead to the inevitable conclusion that the law allows TTB to adopt a standard other than the proposed 0.5% ABV limit, including one that would require that only a majority of the alcohol in a malt

beverage to come from a malt base.

Where the government seeks to change longstanding policy and impose new regulations, it bears the burden of justifying the proposed new regulations, See, e.g., JSG Trading Corp. v, United & States Dep’t of Agriculture, 176 f.3d 536, 544 (D.C. Cir. 1999). Simple fairness requires that Notice 4 articulate a compelling reason for changing federal policy, as the change will disrupt business investments and consumer expectations. Simple fairness dictates that Notice 4 attempt to accommodate businesses that reasonably relied on more than thirty years of explicit and implicit approval of the use of non beverage flavors in FMBs. It is unfair to others in the industry for TTB to adopt a standard that will hand a compctitive advantage to a few key players in the beer category.

2. TIMING FOR IMPLEMENTATION

Brown-Forman has invested considerable sums in developing, testing and marketing our FMB products. As Notice 4 acknowledges, the industry will need significant time to develop a product given the ‘substantial change from existing regulations and policy.” See 68 Fed. Reg. at 14296. To meet eithcr the 50% or .05% standard, Brown-Forman projects a reasonable production launch date to be January 2006 assuming a final rule is issued by TTB by the end of this calendar year. The next two years will involve significant work both on formulation and production capabilities. Key hurdles include:

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• Brown-Forman recently built a pilot version of equipment used to clean the malt base for a 51% or .05% standard for FMBs. We arc currently testing the equipment to evaluate performance.

• Malt base produced by the pilot equipment will be used in formulating our FMBs pursuant to the new standards adopted by TTB. These FMBs will then need to be subjected to shelf life tests for a twelve month period. This length of time does not address potential reformulations if product fails shelf life tests.

• Once product is deemed acceptable in flavor and shelf life, then our engineers will design and build a full scale cleaning system that can handle to volume of malt base needed for our existing products. This would take at least six months.

• Once full-scale equipment is installed, we anticipate three months to test new equipment and product produced.

Reformulation work necessary to meet either a 51% or a .05% standard involves millions of dollars in capital investment for equipment to clean the malt base. Brown-Forman strongly suggests a two year timetable to prudently transition to the new formulation standard is inherently fair and warranted given TTBs radical departure from formulation standards producers have relied upon for more than thirty years.

Considering this, Brown-Forman further urges TTB to clearly communicate a realistic effective date of the new rules. Any new rule should apply only to product manufactured on or after the effcctive date. FMBs already in the market, whether in producers' or wholesalers' warehouses or in retailer inventories, should remain unaffected by the new formulation standards. The final rule also should acknowledge that TTB will continue to approve SOPs and COLAs for FMB products formulated according to current standards up until the effective date of the regulations.

3. TTB SHOULD REQUIRE ALCOHOL CONTENT LABELiNG FOR ALL MALT BEVERAGES

Brown-Forman agrees with Notice 4 that alcohol content is important consumer information that should appear on malt beverage labels. See 68 Fed. Reg. at 14297. We disagree with Notice 4, however, in its suggestion that FMBs mislead consumers about their alcohol content, and urge TTB to issue final rules requiming alcohol content labeling for all malt beverages.

Notice 4 again claims the existence of consumer confusion concerning FMB alcohol content without any evidence of tho same. Specifically, the Notice claims that consumers are